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MONEY AND REFORM: A STABLE MONETARY ARRANGEMENT

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I. The Issue

Until recently monetarists did not explicitly argue the case for the endogenization of money and monetary institutions in their discussions of reforms. Many monetarists continue to argue that these institutions are exogenous and thereby subject to the exercise of a Smithian freedom of choice in selecting and mounting monetary reform. To be sure the character and type of monetary institutions and the role of money are to a good measure determined by their socio-political and economic environment.[1]

Whatever approach is correct and appropriate economists do agree on the importance of ideas and the considerable lag between these ideas and their execution. And, indeed, John Maynard Keynes put the issue succinctly at the end of his General Theory: "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back."[2]

There are reasons for the existence of the lag. Milton Friedman argues that one reason why economists have a difficult ntime in convincing

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[1] *See George Macesich and H. Tsai, Money in Economic Systems (New York: Praeger Publishers, 1982), 25.*

[2] *John Maynard Keynes, The General Theory of Employment, Interest and Money (New York: Harcourt, Brace, and World, First Harbinger Edition, 1964), 383.*

policy makers is that they assume policy makers always wish to do the right thing.[3] That is, they assume that policy makers have the public interest as their primary concern. According to Friedman, policy makers primarily think of their interest, although they believe that it coincides with the public's interest.

The implication of our discussion for the reform of former socialist countries is clear. The processes will be long and difficult. At this point it is not at all clear that many of the participants have a firm grasp and understanding of the issues involved. And certainly the interests of policy makers do not always coincide with the public's interest.

II. A Stable Monetary Arrangement

If reform is to be successful, the key role that money plays in society must be explicitly addressed. Our discussion suggests the importance writers in the classical and neo-classical traditions attach to money. Its importance is underscored in the reform processes because it comes between man and his objectives. Some writers, including nineteenth century Marxists who saw the idolatry of money as a species of reminisfication, argue that it is alienating or an illusion that led man to believe that he could possess through wealth what he had lost through work-his essence and being.

Thus it is that Georg Simmel, for instance, identifies two likely sources of trouble for the human institution of money.[4] One source is that since individuals do not receive income in kind but rather in money, they are exposed to the uncertainties originating from fluctuations in

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[3] *Milton Friedman, "Economists and Economic Policy", Economic Inquiry XXIV (January 1986); 1-10.*

[4] *Georg Simmel, The Philosophy of Money. Translation by T. Bottomore and D. Frisby, with Introduction by D. Frisby. (London and Boston: Rutledge and Keegan Paul, 1977, 1978), 160.*

the purchasing power of money. The other is that the very success of a "free monetary order" encourages the development of socialist or collectivist ideas which serve to undermine the individualistic order based on free markets and money.

Monetary uncertainty will tend to move the social order away from the use of money and markets toward a greater reliance on one form or another of greater government control or command organization thereby strengthening bureaucracy and its political influence. Furthermore, monetary instability and market failure are closely linked and both serve to weaken the social fabric.

The use of the monetary system and monetary policy to pursue changing goals and objectives threaten society's responsibility to maintain trust and faith in money. This in turn casts doubt on the monetary organization and indeed market democracy itself. The nineteenth century view of society's responsibility to maintain trust and faith in money was supported by the bitter eighteenth century experiences with currency excess. Most classical and neoclassical economists underscored society's responsibility to preserve trust and faith in money.

Many of these economists would be less than enthusiastic in support of discretionary monetary policy to exploit the presumed short-run non-neutrality of money to increase permanent employment and output by increasing the stock of money. They would agree that although an arbitrary increase in money will not necessarily permanently disrupt relative prices, such manipulation sets into motion forces whose consequences for social stability are very serious indeed. Since there is no human power that can guarantee against possible misuse of the money issuing authority, to give such authority to government is to invite destruction of the social order. It is for this reason that they argued that it is best to tie paper money to a metal value established by law or the economy.[5]

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[5] *Georg Simmel, The Philosophy of Money, 160*

It was also John Maynard Keynes in his Economic Consequences of the Peace (1919), who told us there is no better means to overturn an existing social structure than to debauch the currency.[6] He also alleged that Lenin espoused that the best way to overthrow the capitalist system was to debauch the currency. Ironically, some can argue that Keynes' subsequent teaching opened the flood gates of inflation in the post-World War II period, even though he personally attempted to close those gates shortly before his death in 1946.[7]

Keynes clearly shared a monetary heritage common to the classical and neoclassical schools of economic thought. What sets him apart were his views on the conduct of monetary policy. For instance, Milton Friedman writes that where he disagrees with the views Keynes expressed in Monetary Reform is with the appropriate method for achieving a stable price level. Keynes favored managed money and managed exchange rates, that is, discretionary control by monetary authorities.[8]

It is the exercise of discretionary policy by monetary authorities advocated by Keynes that underscores his differences with Monetarists led by Milton Friedman and F.A. Hayek's Austrians. His desire to place the execution of monetary policy at the discretion of public-spirited and competent civil servants sets him in disagreement with monetarists who argue for a growth rate rule for some definition of the money supply.

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[6] *John Maynard Keynes, Economic Consequences of the Peace. (London: Macmillan, 1920).*

[7] *F.A. Hayek, "The Keynes Centenary: The Austrian Critique, "The Economist (June 11, 1983), 39.*

[8] *Milton Friedman, "A Monetarist Reflects: The Keynes Centenary", The Economist (June 4, 1983), 19.*

The value of market democracy is questioned by people who do not believe that it is possible to make it work in terms of specific goals which society should, in their opinion, pursue. The exercise of market democracy implies that it is possible for individuals to choose between a multiplicity of ends. This in turn requires that no arbitrary or capricious steps will be taken to alter this exercise in favor of particular individuals, groups, or interests. The importance of money and the monetary organization is clear. A stable and predictable monetary policy can not survive if it is directed to the shifting goals of price stability, full employment, economic growth, and economic equality. It will change with the goals adopted.

GUIDELINES FOR MONEY IN REFORM

It is useful to consider briefly guidelines put forward by important views of money for a stable monetary organization to serve reform. If monetarist guidelines are adopted, this requires acceptance of monetarism's principal tenet, as in the quantity theory of money, that inflation is at all times and everywhere a monetary phenomenon. Its principal policy corollary is that only a slow and steady rate of increase in the money supply-one in line with the real growth of the economycan ensure price stability.

Milton Friedman (The Counter-Revolution in Monetary Theory, First Wincott, Memorial Lecture (London: Institute of Economic Affairs, 1970)) summarizes the monetarist view on the relationship between the money supply and price level.

1. There is a consistent, though not precise, relation between the rate of growth of the quantity of money and the rate of growth of nominal income.
2. This relationship is not obvious to the naked eye-largely because it takes time for changes in monetary growth to affect income. How long this process will take is within itself a variable.

3. An average change in the rate of monetary growth produces a change in the rate of growth of nominal income to about six to nine months later. This is an average which does not hold in every individual case.
4. The changed rate of growth in nominal income typically shows up first in output and hardly at all in prices.
5. The average effect on prices comes about six to nine months after the effect on income and output, so the total delay between a change in monetary growth and a change in the rate of inflation averages around twelve to eighteen months.
6. Even after allowances for delays in the effect of monetary growth, the relation is far from perfect, for there's many a slip "twist the monetary change and the income change".
7. Short-term monetary changes of five or ten years primarily affect output over decades, although the rate of monetary growth affects prices primarily.

The monetarists' view, as summarized in Friedman's Counter-Revolution, questions the doctrine advanced by Keynes that variations in government spending, taxes, and the national debt could stabilize both the price level and the real economy. This doctrine has come to be called "The Keynesian Revolution".

The "Austrian School", through members as Carl Menger, Georg Simmel (a sociologist), Ludwig von Mises, and Friedreich von Hayek, provides useful insights into the monetary system as an integral part of the social structure. They also serve as guides to monetary reform. Their views differ significantly from both Keynesian and monetarist views, although Milton Friedman and some monetarists come closer to the Austrians in their emphasis on "monetary rules" and a stable monetary order.

According to the Austrian view, money and the monetary system is the unintended product of social evolution in much the same fashion as

the legal system.[9] Money is a social institution-a public good. It is not simply another durable good held in the form of "real balances" by utility maximizing individuals or profit maximizing firms as Keynesian and monetarist views hold. However, useful the tools of supply and demand analysis applied to money as a private durable good, Keynesians and monetarists miss the full consequences of monetary instability.

In essence, the monetary system is an integral part of the social fabric Whose threads include faith and trust which makes possible the exercise of rational choice and the development of human freedom. This is misunderstood by the very people who benefit from it. It is this misunderstanding of the social role of money as a critical element in the market mechanism and the need for confidence in the stability of its purchasing power that came to dominate much of Keynesian and monetarist monetary thought in the postwar period. This misunderstanding is the ideological key to the use of discretionary monetary policies for monetary expansion as an unfailing means of increasing output and employment and reduction interest rates.

Herbert Frankel writes that Keynes, following Georg Friedrich Knapp, presents the monetary system as a creation of the state as such available for manipulation by government consisting mostly of wise and well-educated people disinterestedly promoting the best interests of society. The fact that such an arrangement curtails individual choice and decision did not disturb Keynes, who saw little reason to believe that those choices and decisions benefit society. In essence, it is at best and elitist view of government so familiar to Great Britain at the turn of the century or at worst a totalitarian government on the model

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[9] *David Laidler and Nickolas Rowe, "Georg Simmel's Philosophy of Money: A Review Article for Economists", Journal of Economic Literature (March 1980), 97-105; S. Herbert Frankel, Two Philosophies of Money: The Conflict of Trust and Authority (New York: St. Martin's Press, 1977); and Review of Frankel's study by David Laidler in Journal of Economic Literature (June 1979): 570-572.*

of the Soviet Union.[10]

David Laidler takes exception to Frankel's argument that Keynes is the architect of short-run monetary policy that seeks to exploit monetary illusion in order to trick people into taking actions which, if they could correctly foresee their consequences, they would not take. Such "trickery" is not the policy product of the 1930s when Keynes believed that undertaking an activist monetary policy to deal with unemployment would be what individua; agents desired but were prevented from accomplishing on their own because of price and market mechanism failure. Keynes, in effect, thought he was dealing with the issue of involuntary unemployment. It was in the 1950s and 1960s that the ideal of a stable inflation-unemployment tradeoff generated a "money illusion" available for exploitation by policy makers.

In my view, Laidler is correct that policies derived from Keynesian philosophy of money may not be the fundamental reason that faith in the institutions of a free society is threatened. Though, again, the policies of the 1950s, 1960s and 1970s do owe much to Keynes' followers, if not Keynes himself. Keynes did provide, however, the theoretical apparatus to make possible the articulation of his postWorld War I vision. It was in the late 1970s and 1980s that the "chickens came home to roost", so to speak, with the era of rational expectations and growing distrust of government.[11]

One can attribute too much responsibility to Keynes and his followers for the lack of faith and trust in the "old order", as argued by the followers of the Austrian view of money. Indeed, the durability of the old order was questioned by Simmel long before Keynes and his followers appeared.

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[10] *For a discussion of this issue, see George Macesich, The International Monetary Economy and the Third World (New York: Praeger, 1981). Chapters 1-2 and references cited there.*

[11] *George Macesich, Monetary Policy and Rational Expectations (New York: Praeger, 1987).*

This durability is questioned by Simmel throughout his Philosophy of Money. His study, as we noted, is concerned not simply with money as a unit of account, a store of value and medium of exchange-but with the free market economy in which the monetary system is an integral part, and with the relationship between the institution of such an economy and justice, liberty, and the nature of man as a social being. The focus is on exchange as one of the most fundamental functions which serves to tie individuals into a cohesive social group. Since barter exchange is inconvenient, there naturally developed a group of individuals who are specialists in exchange and the institution of money which serves to solve the problem of the dual coincidence of barter. As soon as money enters the picture and the dual coincidence of barter is resolved, exchange ceases to be a simple relationship between two individuals. Simmel notes that the ensuing generalization of claims made possible by money transfers places these claims for realization upon the general economic community and government as its representative. Unlike other things that have a specific content form which they derive their value, money derives its content, according to Simmel, from its value. In turn, its value owes much to the implicit guarantee given by society and the community and little to the physical properties of money. It is, in effect, based on the confidence in the sociopolitical organization and order. In this view, the British pound sterling, formerly, and the American dollar, currently, owe their value more to the political and economic power and prestige of their institutions than to the physical properties of the pound and dollar. This confidence in the political and economic institutions of a country is "trust".

"Trust" the is the ingredient that bond society together and the more of it individuals have in a society's institutions in general and its money in particular, the more extensive and intense the use of money will be in a economy. By and large the consequences of such developments are beneficial to the society in that man's achievements are enhanced not only in the economy but in all other endeavors. Indeed, freedom and justice are promoted by the development and growth of exchange and the monetary economy.

Consequently, the individual is able to act independently of other individuals while at the same time becoming more depending on society as a whole. That is, and individual becomes more dependent on the achievements of individuals and less so on the peculiarities of personalities. The loosening of bonds serves to promote economic freedom. It may or may not promote political freedom at the same time.

Keynes, too, was concerned with monetary stability and the fragile nature of a money-using market economy and the social order that went with it. He was also well aware of the need for trust in the stability of purchasing power if the market mechanism was to function properly. Indeed, to Keynes money is not just another commodity. A money economy is very different from a barter economy. The idea was lost, write Laidler and Rowe, as the Hicksian IS-LM (Investment/Saving-Liquidity Money) interpretation of the General Theory came to dominate monetary economics, monetarist as well as so-called Keynesian. The dominance of this incomplete version of Keynes in subsequent debates has surely been the main reason for their participants having neglected "Austrian" ideas on these matters.[12]

The story, however, is very different on the conduct of monetary policy where Keynes and his followers depart significantly from the Austrian and monetarist paths. These differences are so profound as to overwhelm areas of agreement. As we note, Keynes believed firmly in discretionary monetary policy and viewed the gold standard as a relic. Modern Austrians hold to the gold standard. The monetarists argue for a given growth rate in the stock of money. The difference between the Austrians and the monetarists is essentially about means to achieve agreed upon ends, although the latter do not stress the role of stability in promoting trust and so facilitating the functioning of markets. The Austrians, while distrusting the bureaucrats, are more skeptical than monetarists about the stability of the demand for money function and so argue for pegging the price of money in terms of gold, relying on the stability of the relative price of gold in terms of goods in general.

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[12] *Laidler and Rowe, "Georg Simmel's Philosophy of Money", 103.*

Frankel, in his study **Two Philosophies of Money,** directs attention to the erroneous "nominalist" theories of money which imply that money is something external to the fabric of society, a thing or commodity in its own right, which governments are entitled to manipulate in pursuit of their own limited economic or social ends. He draws and compares the views of Simmel and Keynes, arguing that both understood the economic uses and psychological power of money. Simmel and Keynes were also sensitive to its resultant influence on human character and behavior. More important, perhaps, Frankel demonstrates how the views of Simmel and Keynes summarize the conflicting ideologies of the nineteenth and twentieth centuries and serve to place in perspective contemporary monetary problems.

Differences in monetary views will manifest themselves in reform guidelines. Thus Keynes and many of his followers believe that a free monetary order might not work in terms of specific goals which society should, in their opinion, pursue. This view, shared by Keynes, leads to utopian attempts to make the uncertain certain by control of society according to plan as well as by transformation of man. Its adherents believe that we now possess the technical tools and scientific knowledge to enable us to control monetary behavior, not only within a nation, but even internationally, and thereby not only the rate of economic change, but progress also. Monetarists, on the other hand, would support Friedman's view that "we are in danger of asking it to accomplish tasks that it cannot achieve and, as a result, in danger of preventing it from making the contribution that it is capable of making."[13]

What guidelines for reform are forthcoming from Keynes? According to Hicks, Keynes, in his search for a workable monetary standard, founded the labor standard and its dependence on society's sociopoliticall processes in the General Theory.[14]

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[13] *Milton Friedman, "The Role of Monetary Policy", in The optimum Quantity of Money and other Essays (Chicago: Aldine Publishing, 1969), 99.*

[14] *John R. Hicks, "The Keynes Centenary: A Skeptical Follower", The Economist (June 18, 1983), 17-10.*

Because of other things, this translated into a managed monetary standard and justification for its discretionary management by central monetary authorities composed of an enlightened elite.

Keynes' efforts were translated into a "managed monetary standard" and yielded readily to discretionary monetary manipulation by authorities. The consequent monetary uncertainty generated by such manipulation has had the effect on balance of casting doubt on the credibility of these authorities, their policies, and ultimately on the monetary regime itself. In the process, the long=term price level has lost its anchor. These are only the more obvious unintended consequences of Keynes' efforts.

The unintended consequences of Keynes' search for a workable monetary standard are but another illustration of money in history and the unintended perverse effects. The best intentional changes do at times lead via unintended consequences to undesirable results. Keynes' efforts are no exception.

Indeed, the idea that the unintended effects of human actions and decisions often have unforeseen consequences came into currency in the eighteenth century confidently supported the belief that institutional changes can be so engineered a to bring about a perfect society.[15] The idea of the perfectible society is deeply embedded in critiques of social and economic order. By the beginning of the nineteenth century, the idea served to launch strong criticism of capitalism and the social and economic order it represented. In the twentieth century, the idea also served Keynes in his search for a workable monetary standard.

In fact, Keynes' flexibility and fine tuning propensities are certainly consistent with ideas flowing from the French Enlightenment. His propensities, writes Friedman, "were in accord with his elitist political philosophy, his conception of society run by an able corps of public spirited intellectuals entitled to power that they could be counted on to

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[15] See Albert Hirschaman, "Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble?" Journal of Economic Literature (December 1982): 1463-84.

exercise for the masses. They may also have been related to an excessive confidence in his ability to shape public opinion.[16] His flexibility and attribution to others of his own capacity to change his views by changing circumstances also led to serious misreading of matters far removed from economic policy.[17]

An example of Keynes' flexibility and misreading of events is provided by Hayek when he writes, "I am convinced that he owed his extraordinary influence in this field (economics), to which he (Keynes) gave only a small part of his energy, to an almost unique combination of other gifts." He had gained the ear of the "advanced" members much earlier and contributed greatly to a trend in conflict with his own classical liberal beginnings. The time when he had become the idol of the leftist intellectuals was in fact when in 1933 he had shocked many of his earlier admirers by an essay on "National Self-Sufficiency" in the New Statesman and Nation (reprinted with equal enthusiasm by the Yale Review the Communist Science and Society and the National Socialist Schmollers Jahrbuch).[18]

In the essay in question, Hayek quotes Keynes:

> The decadent international but individualistic capitalism, in the hands of which we found ourselves after the war is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous-and it does not deliver the goods. In short, we dislike it and are beginning to despise it.

Hayek writes that Keynes later and in the same mood state in the preface to the German translation of the General Theory,

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[16] *Milton Friedman, "The Keynes Centenary: A Monetarist Reflects', The Economist (June 4, 1983), 17.*

[17] *Milton Friedman, "The Keynes Centenary", 18.*

[18] *F.A. Hayek, "The Keynes Centenary: The Austrian Critique", The Economist (June 11, 1983), 41.*

> ... he (Keynes) frankly recommended his policy proposal as being more easily adapted to the condition of a totalitarian state than those in which production is guided by free competition.[19]

Criticism of capitalism's shortcomings is a view that Keynes shared with other contemporaries. Keynes, of course, was also a man with a very sharp sense of history, theory, and policy. In Chapter 24, "Concluding Notes on the Social Philosophy Toward Which the General Theory Might Lead" of his General Theory, he writes that

> ... the authoritarian state systems of today seem to solve the problem of unemployment at the expense of efficiency and freedom. But it may be possible by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom.[20]

Keynes, the liberal economist, was certainly well aware of the advantages and value of individualism and the capitalist market system. Thus, he writes,

> Whilst, therefore, the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest would seem... both the only practicable means of avoiding the destruction of existing economic forms in their entirety and the condition of the successful functioning of individual initiative.

In effect, Keynes felt that shortcomings of the capitalist market-oriented individualist system could be overcome with appropriate policies of government intervention while at the same time preserving the systems's efficency and freedom. On this point, Keynes is consistent with the eighteenth century view that social engineering via appropriate

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[19] *F.A. Hayek, "The Keynes Centenary", 41.*

[20] *J. M. Keynes, The General Theory of Employment, Interest, and Money (New York:Harcourt, Brace, and World, Inc., First Harbinger Edition, 1964), 381.*

government policies can improve society's lot. Indeed, Keynes is also consistent with the "self-destruction thesis" of capitalism discussed by Albert Hirschman and many other past and present writers, including conservatives and Marxists.

The serious misreading of public policy on Keynes' part suggested by Friedman and confirmed by post-war events underscores the importance of constraining a country's bureaucratic and political elite. It is clear that such constraint should be within a system of well-defined rules as advanced by Milton Friedman and other monetarists. This is particularly the case in the application of monetary guidelines to reform.

The reason is straightforward. We do not have at our disposal scientific knowledge that would justify fine tuning monetary policy with any reasonable expectation of success. To give bureaucrats, in this instance central bankers, discretionary power to fine tune monetary policy is to ask them to do the impossible. Thus monetarists (or quantity theorists) urge a policy system based on rules and nondiscretionary intervention into the economy. Its principal policy corollary, as we have noted, is that only a slow and steady rate of increase in the money supply-one in line with the real growth of the economy-can insure price stability.

This is, of course, disputed by people whose preference is administrative discretionary intervention to maintain aggregate demand in the economy. The central issue in the disagreement, essentially, is over defined versus undefined or discretionary policy systems. On this score the major opponents of the monetarist position are modern Keynesians and central bankers whose position is that defined policy systems are inferior to administrative discretion. In effect, the modern Keynesian position and that of central bankers does not involve a search for optimal decision rules for monetary (and fiscal) policy. Central bankers are more or less in accord since it is consistent with their view that the conduct of monetary policy is an "art" not to be encumbered by explicit policy rules.

The modern Keynesian approach is, in effect, the economic branch of the political interventionist position whose defining principle is the

extensive use of government power without definite guides or policy systems. It has important allies in central banks with whom it shares many banking school ideas. Its opponents, including Monetarists, are those seeking lawful policy systems and limitations on the undefined exercise of power by government.

Culbertson puts it well when he writes,

> A basic difficulty with undefined policy systems... is that since the policies to be followed are uncertain, they may prove to be disastrously inappropriate. Such policy systems are risky. The intellectual difficulty of the proponent of discretionary policy formation is a real one. If the policy matters, then certain correct choices must be made, which that power must reside in those particular men who will make the correct decisions-but in a context in which the correct choices themselves are asserted to be incapable of being defined (since it is the basis of rejection of defined policy systems). Inevitably, it seems, the approach implies the existence of an elite or priestly class that promises to accomplish the indefinable.[21]

For the discretionary outcome, it does matter which economist sits at the elbow of which President or Prime Minister after all. The Monetarist position is that a "political economist" is really not needed, given a well-defined policy system.

The Austrian view for monetary guidelines includes some form of gold standard as constraint on the domestic and international monetary system. Gold proposals, however, have not met with notable success.[22]

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[21] *John M. Culberison, Macroeconomic Theory and Stabilization Policy (New York: McGraw-Hill Book Company, 1968), 535.*

[22] *See a useful summary by M. D. 8ordo, "The Classical Gold Standard: Some Lesson for Today", Review, Federal Reserve Bank of St.Louis (May 1981):1-16; 8leiberg and J.Grant, "For Real Money: The Dollar Should Be as Good."Editorial commentary in Baryon's (June 15, 1981); L. E. Lehrman and Henry S. Reuss debated issue "Should the U.S. Return to the Gold Standard?" Christian Science*

This in not surprising. What is often lacking in these proposals is an appreciation and understanding of the fact that the gold standard was more than a monetary standard. It cannot be understood, as it cannot be operated successfully, except as part of a socioeconomic, political, and philosophic system in which it was developed. This system no longer exists for reasons discussed above.

Moreover, there is a tendency for some gold advocates to idealize the gold standard and to overlook some of its more troublesome aspects. Thus between 1815 and 1914, there were twelve major crises or panics in the United States which pushed up interest rates, created severe unemployment, and suspended specie payments (conversion of the dollar into gold) in addition to 14 more minor recessions.[23] Between 1879 and 1965, a period when America was on some sort of gold standard, the consumer price index rose by an average of only 1.4 percent a year. On the other hand, the severe bouts of inflation were followed by deep deflation in which prices actually fell. For instance, in the 1921 world recession, when production actually fell for only a few months, there were 30-40 percent cuts in manufacturing wages in some countries in the period 1920-1922.

An alternative proposal, which was pushed from theory to practice by F.A. Hayek, is that governmental monopoly in the supply of money be

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Monitor (September 21, 1981); The Economist (September 5, 1981); 11-12 (the report of the U.S.Gold Commission studying greater role forgold in the United States): see also Martin Bronfenbrenner, "The CurrencyChoice Defense." Challenge (January/February 1980); 31-36:

The gold clause was relegalized by Section 463 of the U.S. Code in October 1977. Little publicity has been accorded change; few people know about it; any ruse of gold clauses may lead Congress to reverse its 1977 action. On the other hand, that action may be a straw in the wind; it has friends in Congress; extension of the legal tender privilege to other currencies and thus freer competition between currencies may be closer in the U.S. market than anyone realizes. (Ibid.36)

See also Anna J. Schwartz, "The U.S. Gold Commission and the Resurgence of Interest in a Return to the Gold Standard." Proceedings and Reports, Vol.17 (1983) Tallahassee: Center for Yugoslav-American Studies, Research, and Exchanges, The Florida State University; Dr. Schwartz was Executive Director of the U. S. Gold Commission.

[23] *The Economist (September 19, 1981): 17-18.*

abolished and that the provision of money be left to an unregulated market.[24] Hayek contends that with private provision of money, money users would receive a better product, and the problems of business cycles would be ameliorated. Pre-1860 American monetary experience with multiple private currencies sheds light on the feasibility of Hayek's proposal. The ultimate constraint on the American monetary system was the specie or gold standard; Hayek's proposal on this score is not clear.

Another reform proposal is to opt for a fiduciary monetary standard within a monetary constitution on the national level. This is essentially a Monetarist proposal on the national level. It is suggested by Leland Yeager and James Buchanan and incorporates a Friedman-type rule on the rate of monetary growth.[25] On the international level, fully flexible exchange rates would replace the existing "dirty-float" system of exchange rates.

One merit of the proposals for constraining the monetary system by a monetary constitution and rule is their implicit recognition that the nineteenth century integration of market processes has been impaired over the past several decades by the emergence in every country of a grater measure of state intervention and particularly the discretionary nature of such intervention in the monetary sphere.

The monetarist measures advanced as guidelines for monetary reform are not necessarily a cure-all for the troubles in the monetary system.

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[24] F.A.Hayek, Denationalization of Money (London: Institute of Economic Affairs, 1976).

[25] See Leland 8. Yaeger, ed., In Search of a Monetary Constitution (Cambridge: Harvard University Press, 1962); James Buchanan, "Predictability: The Criterion of Monetary Constitutions," ibid., 155-83; Milton Friedman, "Should There Be an Independent Monetary Authority?" ibid., 219-43; Friedman and Schwariz, Monetary History, Mi/ton Friedman, A Program for Monetary Stability (NewYork: Fordham University Press, 1959). See also Robert E.Lucas, Jr. "Ru/es, Discretion, and the Role of the Economic Advisor," in Rational Expectations and Economic Policy, edited by S. Fischer (Chicago: University of Chicago Press, 1980), 199-210; T.J. Sargent and N. Wallace, "Rational Expectations, the Optimal Monetary Instrument, and the Optimal Money Supply Rule," Journal of Political Economy 83 (1975): 241-54.

They are in keeping with objectives of those seeking defined guides within lawful policy systems. Since these measures could also constrain central bankers in their exercise of discretionary monetary authority and thus limit the practice of their "art", these measures are not likely to generate much enthusiasm on their part, especially since central banks would become smaller and less influential bureaucratic institutions. Nonetheless, the uncertainty and the undesirable political implications of discretionary actions by government authorities including central bankers would be curbed.[26]

[26] *A number of these issues are discussed in George Macesich, The Politics of Monetarism: Its Historical and Institutional Development (Totowa, Nj. Rowman and Allanheld, 1984).*